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AGENDA ITEM: 8b

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Consultant Review of Internal Equity Index Program
- II. PROGRAM:** Global Equity
- III. RECOMMENDATION:** Information
- IV. ANALYSIS:**

The annual Wilshire Associates review of the CalPERS internally managed equity index program is shown in Attachment 1. Staff very much appreciates Mr. Schlachter's comments regarding the capabilities and caliber of the internal equity management team, and agrees with his conclusions.

Staff acknowledges the concerns identified by Wilshire and has taken a number of actions to address them. In particular, we have identified opportunities that we feel will provide the scalable structure needed to continue to grow the internal equity programs. These opportunities fall into three areas; Data, Technology and Team Organization.

Data

CalPERS' internal equity team uses custodial portfolio position data to analyze and manage portfolios. Over the past three years, the portfolio position data model has been modified to increase the frequency to daily. The shift to daily data was necessitated by: 1) the increasing number and complexity of the portfolios being managed; 2) the greater frequency of trading activity stemming from the internal management of all transition activity; and 3) more "active" investment objectives being applied to some portfolios.

Recognizing the factors driving the need to change, staff and the custodian have made a number of improvements in an effort to resolve them. These improvements, while aiding the situation, have not been able to overcome the underlying limitations of the current data model. Staff and the custodian are currently engaged in a wide-ranging analysis of how the situation can be resolved.

Technology

The technology environment employed in managing CalPERS' internal equity mandates has improved greatly over the past several years, allowing the scaling of the program to a greater number of portfolios and activities. A significant part of this improvement is the creation of a common platform capable of accommodating most of the types of strategies being internally managed. In order to further evolve the internal management of equity assets, an investment in improved technology will be needed.

There are two main areas in which technology improvements may enhance the internal management process, the first being portfolio construction. Portfolio construction (position analysis and trade generation) is currently completed using several systems and databases, each of which serve their particular need but cannot serve others. In order to build sufficient robustness and scalability, a systems infrastructure that can be leveraged to meet the requirements of all of the various portfolio strategies is needed. Staff is working on solutions that will address this need.

The second area is order management and trade execution. This has been an area receiving a great deal of time and effort. The majority of this effort has been focused on the Charles River order management system. These efforts have been successful to the point that portfolio construction is now the more acute need in terms of enhancements. Nonetheless, further improvements in trading and order management technology continue to be evaluated so that the full functionality required can be obtained.

Managing investment assets is inseparable from having a nimble, flexible technology environment. Having recognized the importance of technology to investment management, INVO and ITSB have partnered to establish a new service model for INVO. This effort is centered on a new structure that will provide leadership, planning and support for the technology needs of the investment office.

Team Organization

The final area of opportunity for improvement relates to the personnel and organizational structure in internal equity management. Concerning structure,

the internal equity management effort has grown to look much more like the equity management group within a leading asset management firm. Due to this evolution, the team needs to have a more functional organization to create the needed expertise, efficiency and back-up capability. An analysis of all the resources available within Global Equity will be done and may result in some redeployment of existing and open positions, as well as requests for additional positions.

V. STRATEGIC PLAN:

This agenda item advances CalPERS Strategic Plan, Goal IX: Achieve long-term, sustainable, risk adjusted returns.

VI. RESULTS/COSTS:

Implementing positive change with respect to the internal equity data, technology and personnel infrastructure will result in a more robust environment modeled after an institutional asset management organization. There will be costs in all three areas but will be addressed as part of the normal budgetary process.

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